

In the United States Court of Appeals
for the Ninth Circuit

KAISER STEEL CORPORATION, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment and Order of the
United States District Court for the
Northern District of California

BRIEF FOR THE APPELLEE

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OPINION BELOW

The findings of fact and conclusions of law of the United States District Court for the Northern District of California (I-R. 31-55)¹ are not officially reported.

¹ "I-R." references are to Vol. 1 of the reproduced record and "II-R." references are to the transcript of the proceedings below.

JURISDICTION

This appeal involves federal income taxes. The taxes in dispute are for the fiscal years ending on June 30, 1949 and June 30, 1950. Taxes in the total amount of \$7,170,062.27 for the taxable year 1949 were paid on November 3, 1949; December 6, 1949, March 2, 1950 and June 14, 1950. (I-R. 2, 15.) Taxes in the total amount of \$7,971,088.80 for the taxable year 1950 were paid on September 15, 1950; December 11, 1950; March 6, 1951 and June 15, 1951. (I-R. 4, 16.) Claims for refund for each of the above-stated fiscal taxable years were filed by taxpayer on October 14, 1953. (I-R. 6-14, 32-33.) In its claim for refund for the taxable year 1949, taxpayer claimed an additional depletion deduction in the amount of \$207,168 (I-R. 7, 32) and on the basis thereof claimed a refund to be owing it in the amount of \$78,723.84 (I-R. 2, 6). In its claim for refund for the taxable year 1950, taxpayer claimed an additional depletion deduction in the amount of \$333,275 (I-R. 12, 33) and on the basis thereof claimed a refund to be owing it in the amount of \$126,644.50. (I-R. 4, 11). The claims for refund were denied by letter dated March 21, 1956. (I-R. 2-3, 4.) Within the time provided in Section 6532 of the Internal Revenue Code of 1954, on March 21, 1957, taxpayer brought an action in the District Court for the recovery of taxes paid for the years 1949 and 1950. (I-R. 1-14.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment of the District Court was entered on November 18,

1966. (I-R. 56.) A motion to amend findings of fact and conclusions of law, to make additional findings of fact and conclusions of law, to alter or amend judgment, and for a new trial was filed by taxpayer on November 21, 1966. (I-R. 57-81.) An order denying the motion was entered on May 26, 1967. (I-R. 82-83.) Within sixty days thereafter, on July 20, 1967, taxpayer filed a notice of appeal. (I-R. 84.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

It is undisputed that taxpayer's depletable "gross income from mining" coal and iron ore, during the taxable years, was the "representative market or field price * * * of a mineral product of like kind and grade," under applicable Treasury Regulations. The question is whether the District Court correctly determined the "representative market or field price" for each mineral.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth in the Appendix, *infra*.

STATEMENT

The material facts, as found by the District Court (I-R. 33-50), may be summarized as follows:

Taxpayer is an integrated miner-manufacturer which mines coal and iron ore and uses these minerals (together with purchased coal and iron ore) in the

manufacture of iron and steel products. As an intermediate manufacturing operation, it produces coke by processing coal it mines and purchases through its by-product coking ovens. The coke, together with a given quantity of iron ore and other materials, is charged into a blast furnace from which iron is obtained. During the taxable years taxpayer mined coal from leased properties at Sunnyside, Utah, and iron ore from its Vulcan Mine in San Bernardino County, California, and its Eagle Mountain Mine in Riverside County, California. (I-R. 33-34.)

During the taxable years taxpayer mined at Sunnyside and shipped to its production facilities the following net tonnages of coal (I-R. 41):

Fiscal year ended June 30, 1949—416,615
Fiscal year ended June 30, 1950—591,568

Nearly all of this coal was used in making coke. Approximately 75 percent of the coal was shipped after washing with the remainder being shipped in an unwashed condition. (I-R. 41.)

The coal mined by taxpayer was, however, also suitable for non-coking (i.e., commercial) uses, and during the taxable years in question taxpayer sold a portion of the coal it extracted from its Sunnyside coal mine. Such sales were in competition with sales of coal not suitable for coking and were sold to the following purchasers in the amounts and at the prices stated (I-R. 42, 43):

For the Fiscal Year Ended June 30, 1949:

<u>Purchaser</u>	<u>Net Tons</u>	<u>Price Per Net Ton</u>
Columbia-Geneva Steel	16,913	\$4.68
Permanente Metals	54	4.57
Utah Fuel Company	8,266	5.70
Denver & Rio Grande Western Ry. Co.	27	4.74
	<u>25,260 ²</u>	

For the Fiscal Year Ended June 30, 1950:

<u>Purchaser</u>	<u>Net Tons</u>	<u>Price Per Net Ton</u>
Sugarhouse Coal Co.	58	\$4.59
Kennecott Copper Co.	4,666	4.64
Columbia-Geneva Steel	19,729	5.00
Idaho-Portland Cement Co.	3,745	4.60
Denver & Rio Grande Western Ry. Co.	142	4.75
	<u>28,340</u>	

The weighted average sales price of these sales was \$5.01 for the fiscal year 1949 and \$4.89 for the fiscal year 1950. Taxpayer used these weighted average prices less royalties in determining its gross income from mining coal in order to compute its depletion allowance for the taxable years in question. (I-R. 43.) That is, on its income tax return for the taxable year 1949, taxpayer determined its depletion allowance with respect to its Sunnyside coal mine by using a

² There was also a transfer made by taxpayer to Kaiser-Frazer Parts in the amount of 75,744 tons. But, as this transfer was made at cost, it was not treated by the Court as being a sale. (I-R. 42.)

price of \$4.6746 (\$5.015 less \$.3404 royalty) per net ton at the mine for its Sunnyside Coal (I-R. 41) and on its income tax return for the taxable year 1950 determined the same depletion allowance by using a price of \$4.5414 (\$4.88 less \$.3386 royalty) per net ton at the mine (I-R. 42). However, in its claim for refund with respect to its taxable year 1949, taxpayer determined its depletion allowance on its Sunnyside coal mine by using a price of \$9.5596 (\$9.90 less \$.3404 royalty) per net ton at the mine (I-R. 41-42) and in its claim for refund with respect to its taxable year 1950, taxpayer determined its depletion allowance on its Sunnyside coal mine by using a price of \$8.5114 (\$8.85 less \$.3386 royalty) per net ton at the mine (I-R. 42).

Utah Fuel Company, the lessor of taxpayer's Sunnyside mine since 1942, was an independent company prior to 1950 which also operated coal properties at Sunnyside, Utah. The properties operated by Utah Fuel were adjacent to the mine leased and operated by taxpayer and was designated "Sunnyside # 1" while that operated by taxpayer was designated as "Sunnyside # 2." (I-R. 43.)

During the years in suit, and the years immediately prior thereto, there was only one washing facility at Sunnyside, Utah and, as both taxpayer and Utah Fuel desired washed coal, the washery was shared. In using the washery, coal mined by taxpayer was comingled with the coal mined by Utah Fuel. Thus, some of the coal that taxpayer sold and some of the coal which it used in its production facility was actually mined by Utah Fuel from the Sunnyside # 1

mine. (I-R. 43-44.) The Sunnyside coal mined by Utah Fuel had all the characteristics of the Sunnyside coal mined by taxpayer, the coals were interchangeable, were in fact interchanged, and were therefore coals of like kind and grade. (I-R. 44.)

Utah Fuel sold the coal that it mined on the open market. All or nearly all of the Sunnyside coal sold by it was used by the purchasers for heating purposes or for making of steam. During the calendar years 1946 through 1949, Utah Fuel sold the following tonnages of Sunnyside coal (I-R. 44):

<u>Year</u>	<u>Net Tons Sold</u>	<u>Average Price Per Ton</u>
1946	308,694.65	\$3.40
1947	265,103.90	4.05
1948	281,167.40	4.80
1949	210,309.75	4.79

In addition, Utah Fuel sold 116,511.5 net tons at \$4.51 per net ton during January, 1950, and 7,558.87 net tons at \$4.31 per net ton during February, 1950. (I-R. 44.)³

Thus, the sales price obtained by Utah Fuel for Sunnyside coal sold at arm's length on the open market during the tax years in question together with the sales made by taxpayer for its Sunnyside coal during the same period established a representative market price for taxpayer's coal for the purpose of determin-

³ Subsequently, taxpayer purchased the stock of Utah Fuel and for all periods thereafter had control over the Sunnyside #1 mine. Although other sales were made from Sunnyside mine #1 after taxpayer acquired Utah Fuel, no evidence of these sales was introduced at trial. (I-R. 44.)

ing its depletion allowance. The representative market price thus established was \$4.75 per net ton for the fiscal year ended June 30, 1949 and \$4.87 per net ton for the fiscal year ended June 30, 1950. (I-R. 45.)

In an attempt to compare coking coals from different sources, several factors must be considered. Among the factors to be considered are the amount of fixed carbon, volatile matter (gases), sulphur and ash that are contained in the coal as well as the plasticity of the coal, with the most important factor being the amount of the fixed carbon. It is the fixed carbon in the coal that iron manufacturers are purchasing when they buy coking coal for it is the fixed carbon which provides the fuel in the blast furnace. (I-R. 45.)

Volatile matter is the gaseous matter which is imprisoned in the coal and which is released when the coal is treated in a coke oven. Although the volatile matter is not deleterious, it must be removed in the coking process. (I-R. 45.)

In an attempt to classify coking coal by grade, the American Society for Testing Materials has prescribed the following guidelines based upon the relative amounts of fixed carbon and volatile matter (in terms of percentage of coal) that the coal contains (I-R. 46):

<u>Coal grade</u>	<u>Percentage of Volatile matter</u>	<u>Percentage of Fixed Carbon</u>
Low-Volatile	14 to 22	86 to 78
Medium-Volatile	22 to 31	78 to 69
High-Volatile	31 to 42	69 and below

Sulphur is a deleterious element in coking coal as well as in iron ore. Unless it is removed in the blast furnace by an industrial process (at additional expense to the manufacturer) it will contaminate the iron and steel and cause it to become brittle. (I-R. 46.)

Ash is the term used in the coking coal industry to describe the impurities in coal other than volatile matter, sulphur, and phosphorous. Some ash may be removed by washing the coal before it is processed into coke. The remaining ash must be removed in the blast furnace. Both of these processes increase a manufacturer's cost of production. (I-R. 46.)

During the years in suit, the Sunnyside coking coal mined by taxpayer and shipped to its production facilities had the following chemical analysis (I-R. 46):

Year	Percentage of Fixed carbon	Percentage of volatile matter	Percentage of ash	Sulphur	Water
1949	54.0	39.0	7.1	1.29	6.7
1950	53.7	39.5	6.8	1.12	7.0

The high-volatile coking coal (that coal which contains less than 69 percent fixed carbon) mined in the Western United States during the years in suit when processed alone in a coke oven produced coke that was physically weak and which tended to pulverize in a ferrous blast furnace. Therefore, it was not feasible to use this coking coal alone. On the other hand, low-volatile coal (that coal which contains more than 78 percent fixed carbon) cannot be used alone in the by-products oven because it tends to swell and would thereby damage the coking oven. Thus, the practice

during the years in issue was to blend a large portion of high-volatile coal with a small portion of low-volatile coal to arrive at a coke with optimum strength at the most economical cost. Low-volatile coals were therefore referred to as blending coals and all of the Western steel producers purchased substantial tonnages of low volatile coal from the mines in the Arkansas-Oklahoma region of the United States. However, the low-volatile coking coal produced in the Arkansas-Oklahoma area could not be used as a complete substitute for taxpayer's Sunnyside coal in the coke making process and therefore was not a mineral product of "like kind and grade" as that mined by taxpayer. (I-R. 46-47).

During the calendar years 1948, 1949 and 1950, the Colorado Fuel and Iron Company of Pueblo, Colorado purchased high-volatile coal from producers in the Raton Mesa area of New Mexico and Colorado for use in making coke. That coal was bought on the open market and the following is the weighted average price of this coal purchased in an unwashed condition (R. 47):

<u>Year</u>	<u>Net Tons</u>	<u>Weighted Average Price f.o.b. mine</u>
1948	640,843	\$4.97
1949	441,253	5.24
1950	515,278	5.43

Nearly all of the coal purchased by Colorado Fuel and Iron Company during 1948, 1949 and 1950 was acquired from the St. Louis, Rocky Mountain and Pacific Company of Raton, New Mexico (hereinafter referred to as "Raton") from its Koehler mine. It was not acquired on a long-term contract basis. In

addition to the sales to Colorado Fuel and Iron Company, Raton sold the following tonnages of its Koehler coking coal to the following parties (I-R. 48):

<u>Year</u>	<u>Tons</u>	<u>Purchaser</u>	<u>Price Per Ton</u>
7	54,138	Sheffield Steel Corp.	\$4.14-4.95
	600 (Approx.)	U.S. Marine Hosp., N. Mex.	5.42
	12,000	Raton Public Service Co.	4.25
	600	N. Mex. Industrial School	4.25
	500	Navajo Ord. Depot, Ariz.	4.70
	600/800	U.S. Post Office	4.70-5.75
	2,500	Nat'l. Sugar Mfg. Co.	4.25
	20,000	Govt purchases (export)	4.39
	Unknown	Reynolds Metal	4.39
	Unknown	Retail Coal dealers	Unknown
8	25,976	Sheffield Steel Corp.	4.95
	218,980	Santa Fe R.R.	5.10 (average)
	75,000 plus	Retail dealers	2.50-2.75
	2,500	N. Mex. Penitentiary	5.65
	66,361	Export	4.49-5.14
	600 (Approx.)	U.S. Marine Hosp., N. Mex.	5.42
	12,000 (Approx.)	Raton Public Service Co.	4.25
	600 (Approx.)	N. Mex. Industrial School	4.25
	500 (Approx.)	Navajo Ord. Depot, Ariz.	4.70
	600/800 (Approx.)	U.S. Post Office	4.70-5.75
	29,754	Kaiser Steel	4.60
	109,019	Santa Fe R.R.	5.14 (average)
	50,000-75,000	Retail dealers	2.50-2.75
	2,500 (Approx.)	N. Mex. Penitentiary	5.65
	600 (Approx.)	U.S. Marine Hosp., N. Mex.	5.42
	12,000 (Approx.)	Raton Public Service Co.	4.25
	600 (Approx.)	N. Mex. Industrial School	4.25
	500 (Approx.)	Navajo Ord. Depot, Ariz.	4.70
	600/800 (Approx.)	U.S. Post Office	4.70-5.75
	39,524	Kaiser Steel	5.00-5.25
	55,272	Santa Fe R.R.	5.50 (average)
	50,000-75,000	Retail dealers	2.50-3.00
	2,500 (Approx.)	N. Mex. Penitentiary	5.65
	600 (Approx.)	U.S. Marine Hosp., N. Mex.	5.42
	600 (Approx.)	N. Mex. Industrial School	4.25
	500 (Approx.)	Navajo Ord. Depot, Ariz.	4.70
	600/800 (Approx.)	U.S. Post Office	4.70-4.75

During the years in question, the Koehler coking coal mined by Raton and shipped to Colorado Fuel and Iron Company had the following chemical analysis in terms of percentage of coal (I-R. 49):

Year	Percentage of fixed carbon	Percentage of Volatile matter	Percentage of Ash	Percentage of sulphur	Percentage of Water
1949	50.9	37.3	11.8	.78	6.7
1950	50.6	37.1	12.3	.75	6.0

In addition, the Koehler coking coal from Raton and taxpayer's Sunnyside coking coal were subjected to various tests to determine their relative plasticity. The plasticity of coal is a physical rather than a chemical characteristic. When coking coal is processed in a coke oven, one of its constituent parts, vitrain, tends to melt and become a viscous liquid as the coal is heated. This liquid comes to the surface of the coke and in the process envelopes and permeates the forming coke. As the coke cools, the vitrain hardens to form a binder for the fixed carbon in the coke. A coking coal which contains more vitrain or whose vitrain flows more readily is described as having greater plasticity. Plasticity gives the coke physical strength so that it does not pulverize or break down in the blast furnace. Thus, the greater the plasticity of a given coal, the stronger is the coke that is made from this coal and the more desirable is the coal for coking purposes. The results of the plasticity tests show that Raton's Koehler coking coal had greater plasticity than taxpayer's Sunnyside coking coal and would therefore tend to form a stronger coke. (I-R. 49.)

Thus, a comparison of the coal mined by Raton from its Koehler mine with the coal mined by taxpayer from its Sunnyside mine shows that the Sunnyside coal contains more fixed carbon (premium) and more sulphur (penalty) while the Koehler coal has more ash (penalty) and greater plasticity (premium). Thus, the advantages of each coal over the other minimizes the competitive economic differences between them. (I-R. 50.)

The Koehler coal and the Sunnyside coal competed directly in the market place, were both suitable for the production of coke when blended with low volatile coal and were similarly utilized. Both coals were also extensively sold for non-coking purposes. They were mineral products of like kind and grade. (I-R. 50.)

The sales prices of the Koehler coal before, during and after the years in question confirms the fact that the sales prices obtained by Utah Fuel for its Sunnyside coal was representative of the market price for Sunnyside coal during the years involved. (I-R. 50.)

In its manufacturing operations, taxpayer used both iron ore that it mined from its own properties as well as iron ore which it purchased from other miners. Taxpayer's own iron ore mining properties were the Vulcan Mine in San Bernardino County, California and the Eagle Mountain Mine in Riverside County, California. (I-R. 33-34.)

During the years in suit, taxpayer mined and shipped to its production facilities the following tonnages (in net tons) of iron ore from its iron ore mining properties (I-R. 34) :

<u>Mine</u>	<u>Fiscal Year Ended June 30, 1949</u>	<u>Fiscal Year Ended June 30, 1950</u>
Eagle Mountain	276,655	835,215
Vulcan	167,970	—

On its income tax return for the taxable year 1949, taxpayer determined its depletion allowance with respect to its iron ore mines by using a price of \$2.89 per net ton of ore at the mine for its Eagle Mountain mine and a price of \$3.13 per net ton of ore at its Vulcan mine. (I-R. 34.) And, on its income tax return for the taxable year 1950, taxpayer determined the same depletion allowance for its Eagle Mountain Mine by using a price of \$3.5455 per net ton at the mine. (I-R. 35.) However, in its claim for refund with respect to its taxable year 1949, taxpayer determined its depletion allowance for its Eagle Mountain Mine by using a price of \$3.584 per net ton at the mine for the period of July 1, 1948 through December 31, 1948 and \$4.371 per net ton for the period of January 1, 1949 through June 30, 1949. And, for its Vulcan mine, it used a price of \$4.263 per net ton at Kelso, California (nine miles from the mine) for the period of July 1, 1948 through December 31, 1948 and a price of \$4.912 per net ton for the period of January 1, 1949 through June 30, 1949. (I-R. 34-35.) In addition, in its claim for refund with respect to its fiscal year 1950, taxpayer determined its depletion allowance for its Eagle Mountain mine by using a price of \$4.903 per net ton at the mine for the period of July 1, 1949 through December 31, 1949, and \$5.376 per net ton for the period of January 1, 1950 through June 30, 1950. (I-R. 35.)

During 1941, 1942, 1943, and early 1944, Utah Construction and Mining Company, formerly Utah Construction Company, was extracting iron ore on a contract basis for Colorado Fuel and Iron Company and for Mr. Senter Walker in the vicinity of Cedar City, Utah. On February 16, 1944, it assumed Mr. Walker's rights under a contract to purchase the property from which it was extracting ore. This property was known as the Iron Springs, Utah Mine. (I-R. 35.) Subsequently, on June 1, 1946, the Utah Construction and Mining Company entered into a contract to sell iron ore from the Iron Springs, Utah Mine to taxpayer. In the years prior to, during, and after the years in suit, Utah Construction and Mining Company sold substantial tonnages of iron ore to taxpayer. (I-R. 35-36.) Following is a schedule of the tonnages and the sales prices for these sales (I-R. 36):

<u>Fiscal Year Ended</u>	<u>Net Tons</u>	<u>Price Per Ton f.o.b. Iron Springs, Utah</u>
June 30, 1946	179,809	\$1.688
June 30, 1947	447,178	2.037
June 30, 1948	381,103	2.037
June 30, 1949	146,501	1.869
<u>June 30, 1950</u>	<u>228,924</u>	<u>1.901</u>
June 30, 1951	376,858	2.11
June 30, 1952	297,982	2.95
June 30, 1953	178,618	4.49
June 30, 1954	165,693	4.72

During the years in suit (which are underlined), the ore that taxpayer purchased from the Iron Springs, Utah Mine constituted over 20 percent of the iron ore consumed by it in its production facilities. (I-R. 36.)

In addition, Utah Construction and Mining Com-

pany was, from 1946 on, (including the years in question), in the business of selling its iron ore to others. Following is a schedule of tonnages and sales prices for the sales made during its fiscal years ended October 31, 1948, 1949, and 1950 to its customers, including taxpayer (I-R. 36-37):

<u>Fiscal Year Ending 10-31-48</u>	<u>Size</u>	<u>Net Tons</u>	<u>Per Ton f.o.b. Mine</u>
Kaiser Company	2½" Minus	266,627.34)	
	2½"x10"	18,273.50)	
Kaiser-Frazer Parts	2½"x5/8"	169,360.15)	\$1.88
Kaiser Company for Lone Star Steel	10" Minus	5,188.35)	
South Dakota Cement Plant	2½" Minus	1,776.45	4.50
Ideal Cement Company	2½" Minus	4,123.75	3.60
Lehigh Portland Cement	2½" Minus	794.60	3.50
Atkins and Kroll	Misc.	248.10	5.13
Balfour Guthrie	Misc.	364.55	6.00
American Foundry & Machine	2½"x5/8"	124.20	6.00
Pacific Steel Company	2½"x5/8"	61.20	5.75
Anaconda	2½"x10"	52.65	6.25
Export Sales	10" Minus	48,499.55	3.18
Total Tons		515,494.39	
Weighted Average f.o.b. Mine Price			<u>\$2.04</u>
<u>Fiscal Year Ending 10-31-49</u>			
Kaiser Company	2½"x10"	41,537.15)	
Kaiser Company	2½" Minus	141,410.45)	
Kaiser-Frazer Parts	2½"x5/8"))	\$2.18
Kaiser-Frazer Parts	5/8" Minus)	145,849.80)	
Ideal Cement	2½" Minus	6,089.35	3.96
Portland Cement	2½" Minus	61.30	4.50
American Foundry & Machine	2½"x5/8"	122.95	6.23
Anaconda	2½"x10"	3,376.86	4.19
Balfour Guthrie	Misc.	73.05	6.25
Carnegie Illinois	2½"x10"	6,714.95	3.52
U.P.R.R. Claim	10" Minus	61.00	4.02
International Smelter	2½"x5/8"	178.85	6.25
Export Sales	10" Minus	39,181.55	3.78
Export Sales	10" Minus	270,293.70	2.36
Total Tons		654,950.96	
Weighted Average f.o.b. Mine Price			<u>\$2.39</u>

<u>Fiscal Year Ending 10-31-50</u>	<u>Size</u>	<u>Net Tons</u>	<u>Per Ton f.o.b. Mine</u>
Kaiser Company	2½" Minus	183,094.10)	\$2.36
Kaiser Company	2½"x10"	111,396.60	
Geneva Steel Company	2½" Minus	371,380.50)	1.29
	2½"x5/8"	51,532.90)	
Carnegie Illinois	2½"x10"	54,044.23	3.57
Anaconda	2½"x10"	4,233.20	4.19
American Foundry & Machine	2½"x5/8"	121.55	6.25
International Smelting & Refining	2½"x5/8"	121.25	6.25
Ideal Cement Company	5/8" Minus	1,772.65	4.00
Idaho Cement	5/8" Minus	501.20	4.00
Oregon Cement	5/8" Minus	991.80	4.00
Utah Portland Cement	5/8" Minus	578.35	4.50
U.P.R.R. Claim	10" Minus	63.20	4.00
Total Tons		779,831.53	
Weighted Average f.o.b. Mine Price			<u>\$1.88</u>

In attempting to compare iron ore from various mines, a number of factors are considered in the iron and steel industry. Among these are the amount of iron contained in the ore (the Fe content), the amount of sulphur (S), phosphorous (P), silica (SiO_2) and other elements in the ore and the moisture content of the ore, i.e., whether it is wet or dry. Since the main purpose for obtaining iron ore is to extract the iron it contains, the most important factor of iron ore is the iron (Fe) which it contains. Thus, the iron ore becomes more valuable as the iron (Fe) content increases. (I-R. 37-38.) Sulphur and phosphorus on the other hand, are deleterious elements in iron ore. They contaminate the manufactured iron and as a result must be removed from the ore by various means prior to its introduction into the blast furnace or by addition of extra fluxing material into the furnace itself. These additional processes increase the

cost of the manufactured product, i.e., pig iron. (I-R. 38.)

The chemical analysis of the iron ore shipped by taxpayer (in the condition as shipped or "natural basis") from its mines during the years involved was approximately the following (I-R. 38):

<u>Fiscal Year Ended</u>	<u>Content of Ore in Percentage</u>					
	<u>Fe</u>	<u>S</u>	<u>P</u>	<u>SiO₂</u>	<u>H₂O</u>	<u>Other⁴</u>
<u>Eagle Mountain</u>						
June 30, 1949	53.11	.365	.109	8.06	3.2	7.53
June 30, 1950	53.07	.393	.085	8.15	3.1	7.51
<u>Vulcan</u>						
June 30, 1949	52.14	1.920	.049	6.33	1.0	9.77

The chemical analysis (natural basis or as shipped) of the iron ore that Utah Construction and Mining Company sold taxpayer during the years in suit was approximately as follows (I-R. 38-39):

<u>Fiscal Year Ended</u>	<u>Content of Ore in Percentage</u>					
	<u>Fe</u>	<u>S</u>	<u>P</u>	<u>SiO₂</u>	<u>H₂O</u>	<u>Other</u>
June 30, 1949	54.59	.031	.294	6.65	4.2	6.14
June 30, 1950	54.59	.031	.298	6.42	4.3	6.14

The iron ore sold by Utah Construction and Mining Company to its customers, including taxpayer, during the tax years in question was similar to taxpayer's Eagle Mountain and Vulcan iron ores in physical and chemical composition. In addition, all of these ores were used for the same purposes in commercial application. (I-R. 39.)

⁴ This includes Alumina (Al₂O₃), lime (CaO), magnesia (MgO), and manganese (Mn).

Iron ore mined in the Western United States was used in the iron and steel industry in blast furnaces and in open-hearth furnaces. In addition, it was used by cement companies. The ore used in open-hearth furnaces had to be in lump form in order to sink through the molten bath. On the other hand, the ore used in blast furnaces had to be crushed and screened to size and must not have contained too many "fines". During the years in suit, the price of the ore that Utah Construction and Mining Company sold taxpayer was the same whether it was destined for use in a blast furnace or in an open-hearth furnace. Except for the differences in the size of the lumps, these ores had the same physical and chemical characteristics. (I-R. 39.)

For the purpose of computing taxpayer's depletion allowance, the iron ore mined by Utah Construction and Mining Company, whether used in a blast furnace, in an open-hearth furnace, or by a cement company is a mineral product of like kind and grade to the ore mined by taxpayer from its Eagle Mountain and Vulcan Mines. (I-R. 39-40.)

Taxpayer purchased no iron ore that was mined in the Great Lakes region of the United States and sold or moved none of its iron ore in that region or at the lower Great Lakes ports. Nor, is there any evidence that any iron ore extracted in the Great Lakes region of the United States was sold and shipped to the Western United States, i.e., California, Oregon, Nevada, Arizona, Utah, Washington, or Idaho. (I-R. 40.)

As the Great Lakes region is remote from the area of taxpayer's operation and because of the absence of any sales or shipments of ores from that area to the area of taxpayer's operation, the Great Lakes area must be considered as an independent market insofar as taxpayer is concerned and sales within that independent market area had no economic effect upon taxpayer's market area. And, during the years involved in this action, the prices commanded by iron ore at the lower Great Lakes ports did not establish a national representative market price for iron ore and did not establish or effect the representative market price for either Eagle Mountain or Vulcan iron ore. (I-R. 40.)

The sales of iron ore by Utah Construction and Mining Company during the tax years in question to its various customers, including taxpayer, were arm's-length transactions in which ore moved in commerce in an area which included taxpayer's mines and therefore established a representative market price for iron ore mined and shipped by taxpayer from its Vulcan and Eagle Mountain Mines during the taxable years in question. (I-R. 40-41.)

The representative market price for the years in issue of the iron ore mined and shipped by taxpayer were as follows (I-R. 41):

For fiscal year ended June 30, 1949—\$2.29 per net ton.

For fiscal year ended June 30, 1950—\$2.03 per net ton.

On the basis of the above evidence, the District Court found, as stated above, that representative market or field prices existed for the coal and iron ore mined by taxpayer and that the representative field

or market price was lower than that claimed in the case of both minerals by the taxpayer in its claims for refund and in fact was lower than the amount which taxpayer claimed in its tax returns in each of the years for each of the minerals and which was allowed by the Commissioner. Accordingly, the District Court ordered that taxpayer take nothing by its complaint and that the complaint be dismissed with prejudice.

This appeal followed.

SUMMARY OF ARGUMENT

This is a mineral depletion case. Taxpayer is an integrated miner-manufacturer who mines coal and iron ore and uses them in manufacturing iron and steel products. It is undisputed that taxpayer is entitled to depletion only on its constructive income from the raw mineral products of its mining operations, and that this income must be determined, under governing Treasury Regulations, by reference to the representative market prices of mineral products of like kind and grade, before transportation. The question presented is whether the District Court correctly determined the representative market prices for taxpayer's coal and iron ore. This is a question of fact. In its detailed findings the District Court has carefully weighed the voluminous evidence of record, and its findings as to the representative market prices are sound.

With regard to taxpayer's coal, the District Court derived its representative market price from open market sales by taxpayer and another company of

coal mined from adjacent mines which had identical characteristics. With respect to taxpayer's iron ore, the court derived the representative market price from substantial sales of such ore in a competitive market embracing taxpayer's area. Taxpayer asserts that the sales data used in both cases is irrelevant, for a variety of reasons, and that constructive figures based on sales by other producers—in another area, in the case of the iron ore—should be used.

The Government submits that the sales data used by the District Court was clearly probative of representative market prices; that the court's findings as to such prices are amply warranted by the record; hence, that the judgment below should be affirmed.

ARGUMENT

The District Court Correctly Determined the Representative Market or Field Prices Which Constitute Taxpayer's Depletion Base for the Taxable Years Involved

A. The statute, the Regulation and relevant decisions

Section 23(m) of the Internal Revenue Code of 1939, Appendix, *infra*, provides that in computing net income there shall be allowed as a deduction, in the case of mines and other natural deposits, a reasonable allowance for depletion "according to the peculiar conditions in each case," and that in all cases the allowance shall be made under rules and regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. Section 114(b)(4)(A) of the 1939 Code, Appendix, *infra*, provides that the allowance for depletion under Section 23(m) shall

(with qualifications irrelevant here) be specified percentages of the "gross income from the property"—5 per cent in the case of coal and 15 per cent in the case of iron ore. For the purposes of these percentage allowances, Section 114(b)(4)(B), Appendix, *infra*, defines "gross income from the property" as "gross income from mining" and, in turn, defines "mining" as including—

not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; * * * (iii) in the case of iron ore, * * * and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; * * *.

In short, depletable "gross income from mining" was defined as income from the "commercially marketable" product of "ordinary treatment processes normally applied by mine owners or operators". And the statute made it clear as to coal and iron ore, at least, that the "ordinary treatment processes" terminated with loading the raw mineral for shipment. However, the statute did not provide similar guidelines as to other minerals mined and used by integrated miner-manufacturers. A number of integrated producers in this latter category contended in the

courts that their finished manufactured products were the first "commercially marketable" products of their "ordinary treatment processes", and that they were entitled to depletion on their gross sales. The Supreme Court rejected this contention in *United States v. Cannelton Sewer Pipe Co.*, 364 U.S. 76, a decision which established significant principles with respect to all integrated producers and their depletion allowances.

In *Cannelton*, the taxpayer mined fire clay and shale and manufactured them into sewer pipe and other vitrified products. It claimed the depletion allowance on its gross sales of the manufactured products, contending that these products were the first "commercially marketable" result of "ordinary treatment processes because it could not sell its raw mineral at a profit, given its underground method of mining. Rejecting this contention, the Court held that (p. 86) raw minerals are "commercially marketable" within the meaning of the statute when they are "ready for industrial use or consumption"—whether or not a taxpayer can sell them at a profit. The Court held further (p. 87):

Ever since the first percentage depletion statute, the cut-off point where "gross income from mining" has stopped has been the same, i.e., where the ordinary miner shipped the product of his mine. * * * As we see it, the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned.

The Court also (p. 86) noted that there were substantial sales of the raw minerals involved, in Indiana (where taxpayer was located) and Kentucky, and characterized these sales as "conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for industrial use or consumption—in short, they have passed the "mining" state on which the depletion principles operate." ⁵

The specific methods by which "gross income from mining" shall be computed has been prescribed for many years by a regulatory provision which, as applicable to the taxable years here involved, was contained in Section 29.23(m)-1(f) of Treasury Regulations 111 (1939 Code), Appendix, *infra*. That section deals first with the simple situation where a miner sells his crude mineral in the immediate vicinity of the mine. In that situation, the miner's depletable income is his gross sales. Section 29.23(m)-1(f) continues—

but if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market

⁵ It is settled, however, that the *Cannelton* principles apply even to a completely integrated industry where there are no sales of the raw mineral on the open market. *Riddell v. Monolith Cement Co.*, 371 U.S. 537; *United States v. Longhorn Portland Cement Co.*, 328 F. 2d 491 (C.A. 5th); *United States v. Light Aggregates, Inc.*, 343 F. 2d 429 (C.A. 8th). In such situations, as set forth in the text, the integrated producer's constructive "gross income from mining" is computed under the proportionate profits method prescribed by the same Regulation here involved.

or field price (as of the date of sale) of a mineral product of like kind and grade as benefited by the ordinary treatment processes actually applied, before transportation of such product.

Finally, the Regulation deals with situations where there is no representative market or field price for the raw mineral, i.e., where there is a largely integrated industry in which the crude mineral is generally not traded and sold because almost every member of the industry mines his own minerals and uses them in manufacturing the end product. In such situations, the Regulation prescribes the proportionate profits method of computing the integrated producer's constructive "gross income from mining."

This Regulation has been in force with few substantive changes since 1940, when it was added to Treasury Regulations 101 under the Revenue Act of 1939 by Treasury Decision 4960, 1940-1 Cum. Bull. 38, and promulgated as Section 19.23(m)-1(f) of Treasury Regulations 103 under the 1939 Code. It is currently in force as Section 39.23(m)-1(e)(3) of Treasury Regulations 118 (1939 Code) which is applicable under the 1954 Code until superseded by new Regulations. (See Section 7807 of the 1954 Code.)

In the depletion area, the broad statutory delegation of regulatory powers reflects recognition by Congress that it "could not foresee the multifarious circumstances which would involve questions of depletion." *Douglas v. Commissioner*, 322 U.S. 275, 281. Moreover, "the highly technical and involved factors entering into a practical solution of the problem of depletion in administration of the tax laws points to

the necessity of interpreting * * * (the applicable statute) so as to strengthen rather than weaken the administrative powers to deal with it equitably and reasonably." *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 103, rehearing denied, 308 U.S. 638. No court has ever questioned the validity of the long-standing Regulation involved in the instant case, and a taxpayer challenging one of the prescribed methods of computation has a heavy burden indeed. *United States v. Portland Cement Co. of Utah*, 378 F. 2d 91 (C.A. 10th).

In the instant case, it is undisputed that taxpayer's depletable "gross income from mining" must be computed constructively under the second method prescribed by the Regulation, i.e., by reference to "the representative market or field price * * * of a mineral product of like kind and grade as benefited by the ordinary treatment processes actually applied, before transportation of such product." The basic criteria for application of this method are clear. Under the statute, percentage depletion is allowed on *gross income from mining*. As the Supreme Court said in *Cannelton* (364 U.S. at p. 87), the cut-off point on such depletable income is "where the ordinary miner shipped the product of his mine," and the integrated producer's (p. 86) "constructive income from the raw mineral product" must be computed at that cut-off point, treating the producer as selling his crude mineral to himself.

Accordingly, a "representative market or field price" must be a price actually charged by a miner for his raw mineral, before transportation, as reflect-

ed in actual sales. Other figures, such as projected market value, value to the owner or replacement value, will not do. Actual sales data is essential to establish the existence of a relevant market and, if it exists, the representative or typical price in that market. If there is a market and a representative price for an integrated producer's raw mineral (or a comparable mineral), they control the computation of his constructive mining income.⁶

In *United States Pipe & Foundry Co. v. Patterson*, 203 F. Supp. 335 (N.D. Ala.), the court said (p. 348):

The search in these coal depletion cases is for market price, not for market value. Where the owner establishes a representative market price for its coal by selling substantial quantities in the market, affected by competitive bargaining and principles of supply and demand, it is entitled to the benefit thereof in computing percentage depletion on all of the coal mined by it during such year. On the other hand, if it elects to exercise its undoubted right to retain all of the coal it mines for use in its integrated manufacturing processes because its intrinsic characteristics impart some added value in the uses to which it is put, this court is of the firm opinion that the best evidence of its representative market price is the weighted average prices of all

⁶ The computation is made by multiplying the representative price by the number of units mined by the integrated producer. This is the so-called "market comparison" method. See *Woodward Iron Co. v. Patterson*, 173 F. Supp. 251, 268 (N.D. Ala.); *Hugoton Production Co. v. United States*, 315 F. 2d 868, 870 (Ct. Cl.).

coal of like kind and grade sold in the district during the year involved. * * *

And, as stated by the Fifth Circuit in *Shamrock Oil & Gas Corp. v. Coffee*, 140 F. 2d 409, 410-411:

Market price is the price that is actually paid by buyers for the same commodity in the same market. It is not necessarily the same as "market value" or "fair market value" or "reasonable worth." * * * Opinions and estimates, and particularly consideration of what the buyers could have paid or should have paid, are entirely irrelevant.

It should be noted that the character of a particular market does not affect the "representativeness" of prices established in that market. A market price may be representative (or typical) of that market regardless of whether the market is a "thin" market or a "fat" market; whether it is a "buyer's" market or a "seller's" market.⁷ There is no warrant in the Regulation or relevant decisions for giving any special meaning to the term "market," as by limiting it to some defined level of competition or minimum number of buyers. To the contrary, in *Alabama By-Products Corp. v. Patterson*, 258 F. 2d 892, 899 (C.A. 5th), certiorari denied, 358 U.S. 930, the court

⁷ For example, Mr. Heiner, formerly president of Utah Fuel, characterized the market for Sunnyside coal as a "buyer's" market (II-R. 333) and Mr. Carrier, an economist, described the market for Utah iron ore during the years in question as a "thin market" (II-R. 639-640). Regardless of whether it was a "thin" market or a "buyer's" market or any other type of market, taxpayer's gross income from mining is to be determined on the basis of the representative market or field price resulting therefrom.

cited with approval the ruling in *Riverton Lime and Stone Co. v. Commissioner*, 28 T.C. 446, that even a small declining market can establish a representative price. And taxpayer itself asserts (Br. 51-54) that the representative price for its coal was established by transactions between one buyer and one seller.

As for what constitutes "of a mineral of like kind and grade" in *United States v. Henderson Clay Products*, 324 F. 2d 7, 11 (C.A. 5th), certiorari denied, 377 U.S. 917, the court said in reaffirming its holding in *Alabama By-Products v. Patterson*, *supra*:

The Alabama By-Products holding was that minerals are of like kind and grade if they are substantially equivalent by commercial standards. Physical, chemical, or geological differences have importance only if they give rise to differences in commercial competition. (Citations omitted) Moreover, the question is not whether the products were actually used for the same commercial purpose but rather whether they *could* have been so used.

B. *The nature and background of the questions presented*

This Court held in *Ames v. United States*, 330 F. 2d 770, 773:

Representative market price is a question of fact. See *Hugoton Prod. Co. v. United States*, Ct. Cl., 315 F. 2d 868, 877. The trial court's finding thereon is not to be set aside unless clearly erroneous and this rule applies not only to the determination of basic facts, but also to factual inferences from undisputed basic facts. *Commissioner v. Duberstein*, 363 U.S. 278, 291.

Truck Terminals, Inc. v. Commissioner, 9 Cir., 314 F. 2d 449, 455.

Taxpayer has candidly acknowledged (Br. 19) the factual nature of the question, citing *Ames*, and has attempted to show that the findings of the District Court are "clearly erroneous". However, it may be noted that taxpayer itself has been beset with continuing doubts along the way as to the representative market prices for its minerals. The representative prices used by taxpayer and the depletion allowances claimed in its returns for the taxable years, as originally filed, were accepted by the Commissioner with relatively minor adjustments. (I-R. 32.) Thereafter, however, in the claims for refund on which this litigation is based, taxpayer claimed substantially higher depletion allowances on the basis of different representative prices. (I-R. 32-35, 41-42.) And, as detailed below, taxpayer has continued to change its position from time to time during this litigation, with respect to the amount and derivation of representative prices.

It is abundantly evident from the District Court's detailed findings that it has carefully sifted and weighed the voluminous evidence of record. We submit that its analysis of the evidence supports its specific and unqualified findings as to the representative market prices for the taxpayer's minerals during the taxable years involved.

C. The record amply warrants the District Court's finding that the sales prices obtained by taxpayer and Utah Fuel Company for coal from their adjacent Sunnyside mines, during the taxable years, established the representative market price for taxpayer's coal

Sales data in three categories were introduced in evidence and considered by the District Court with respect to a representative market or field price for the coking coal mined by taxpayer from its Sunnyside mine during the taxable years: (1) Taxpayer's sales of its Sunnyside coal during the years in suit; (2) Sales by Utah Fuel Company of coking coal from its adjacent Sunnyside mine; and (3) Sales of Raton-Mesa coking coal by the St. Louis, Rocky Mountain & Pacific Company and other companies mining in the Raton-Mesa area of Colorado and New Mexico during 1948, 1949 and 1950.

The District Court found (I-R. 43-44) that the coal mined by taxpayer and Utah Fuel, respectively, from their adjacent Sunnyside mines were of like kind and grade since they had the same characteristics, were interchangeable, and in fact were commingled and exchanged in a common washery. The court further found (I-R. 44-45) that the sales prices obtained for their Sunnyside coal by taxpayer and Utah Fuel, respectively, reflected arm's length sales on the open market, and together (by weighed average) established a representative market price for the taxpayer's coal. Finally, the court found (I-R. 50) that this representative price was confirmed by data as to sales, in the same market and at similar prices, of Raton-Mesa coal with competitive characteristics.

As shown below, the court's analysis of the pertinent sales data of record was sound and fully supports its finding as to the representative market price.

1. Sales of Sunnyside coal by Utah Fuel Company

Prior to and during the years in suit, Utah Coal was an independent mining and merchandising company which owned adjoining mines at Sunnyside. It operated one mine itself and leased the other to the instant taxpayer. The coal in these two mines had the same characteristics, were interchangeable, and in fact were commingled and interchanged in the common washery used by Utah Fuel and taxpayer. (I-R. 43-44.)

During the years 1946 through 1949 Utah Fuel sold substantial net tonnages of its Sunnyside coal on the open market, mostly for heating purposes or making steam. In round figures the tonnages ranged from 309,000 for 1946 to 210,000 in 1949. During the first two months of 1950 Utah Fuel sold 124,000 net tons. In early 1950, taxpayer purchased the stock of Utah Fuel and thereafter controlled the mine Utah Fuel had operated. (I-R. 44.)

Utah Fuel's average sales prices per net ton for 1948 and 1949, respectively, were \$4.80 and \$4.79. (I-R. 44.) The average prices obtained by taxpayer for its Sunnyside coal during the fiscal years in suit (ended June 30, 1949, and June 30, 1950) were \$5.01 and \$4.89 per net ton. The close parallel in prices was no accident; in many instances during 1949 and early 1950 taxpayer priced its own coal by reference

to Utah Fuel's prices. (II-R. 115, 116, 120, 126.) Mr. Heers, taxpayer's Manager of Mines and Raw Materials, testified that (II-R, 115):

The prices that we used, we simply followed the pattern of those that were established by the Utah Fuel Company, who were in the commercial coal business. Some of these sales were taken at the request of Utah Fuel Company to supply their regular customers in instances where the Utah Fuel Company's regular No. 1 mine didn't have enough production * * *.

In short, taxpayer recognized and accepted Utah Fuel's prices as the going market price for the Sunnyside coal.

Taxpayer now urges, nevertheless, that the District Court erred in taking Utah Fuel's sales into account because (Br. 48-49) they were "sales made under peculiar economic conditions and, in effect, distress sales," and that until 1949 these sales were "made at less than cost." This argument is specious and unsound.

To be sure, distress sales at sacrifice prices are unlikely to be representative or typical market prices. More particularly, if a miner produces only one mineral from one mine and sells it below cost—a situation unlikely to continue for any length of time—the price will probably not be representative of prices charged by less irrational producers intent on a profit. But even this is not always the case; in *Cannelton* the taxpayer could not make a profit selling its fire clay and shale at the prices charged by its profit-making competitors because of the high cost of its under ground method of mining.

In any event, an entirely different situation is presented where a producer has diversified operations, only one of which is mining and selling raw minerals, and is making a tidy overall profit on its operations. In such a situation, notwithstanding the overall profit, the sales of raw minerals may be recorded in the taxpayer's books as below cost by reason of allocation of overhead and other accounting practices which the taxpayer has adopted, for a variety of reasons. It does not necessarily follow that the sales of raw minerals contribute to the taxpayer's overall profit—any more than it follows with respect to the sale of bagged cement by a producer who also sells in bulk, simply because the premium for bagged cement is less than the costs of bagging. See *Whitehall Cement Manufacturing Co. v. United States*, 369 F. 2d 468, 474 (C.A. 3d).

Whitehall suggests other considerations. Sales of raw minerals by a diversified producer may, for example, be an accommodation to customers who purchase his other products, or a sales inducement to other customers to purchase minerals he cannot use in his other operations. Whatever the considerations involved, and whatever the bookkeeping legerdemain, the very fact that a prosperous producer continues to sell raw minerals year after year is a sure indication that, directly or indirectly, such sales contribute to his overall profit. The producer must have an overall profit incentive to meet the market prices for raw minerals charged by his competitors, even if his costs of mining are considerably higher than theirs. And

in meeting the competition he is, of course, adopting a representative market price.⁸

In the instant case taxpayer would have it that Utah Fuel was forced to make distress sales of its Sunnyside coal chronically over a twenty-year period, including the years 1946 through 1948. This assertion is refuted by the record. Utah Fuel was certainly not in a condition of financial distress, requiring sacrifice below-cost sales, during the years pertinent here. That company's income statements (Deft. Exs. AA and BB) reveal that it had the following net income for the years 1946 through 1949:

	Net Income (Before taxes)	Net Income (To surplus)
1946	\$256,520	\$192,380
1947	739,893	524,648
1948	465,162	251,540
1949	185,627	72,764

In addition, it had the following earned surpluses during these years:

	Earned Surplus for the year	Total Earned Surplus (Dec. 31st)
1946	\$168,486	\$4,687,975
1947	522,999	5,210,974
1948	368,567	5,579,541
1949	732,240	5,652,782

⁸ As noted above, merely because it was a "buyer's market" as Mr. Heiner described the coal market in Utah in those years (II-R. 333) does not prevent the sales prices of a mineral from establishing a "representative market price." See *Shamrock Oil & Gas Corp. v. Coffee, supra*, pp. 410-411.

Quite obviously, Utah Fuel was not in a distressed financial condition; its overall operations were prosperous and it was therefore under no economic compulsion to unload its Sunnyside coal at sacrifice prices unrelated to the going market price.

The fact that Utah Fuel's books showed a loss on Sunnyside sales during several of these years is misleading. This appears from Mr. Heiner's testimony with respect to the company's contract with Kaiser-Frazer Parts Corporation, in which the price for Sunnyside coal was fixed at \$4.50 per net ton. (Pltf. Ex. 20.) Mr. Heiner, the president of Utah Fuel, made it clear that Utah Fuel profited from the contract because the price received was greater than the company's direct mining costs, although less than the direct costs plus allocated overhead. (II-R. 339-341.) The reason is evident. Since the overhead would have to be paid, regardless of the volume of sales, Utah Fuel was better off financially for having made the sales to Kaiser-Frazer. And with enough sales at \$4.50 a ton, it might have made a substantial profit on these sales, regardless of overhead allocations.

Significantly, taxpayer mentions only in passing the profits realized by Utah Fuel from sales of Sunnyside coal during 1949. Of all the years involving such sales, 1949 is the most important since it encompasses six months of each of taxpayer's fiscal years in suit. The record shows that Utah Fuel made a clear profit of 11 cents per net ton on its sales during 1949. (II-R. 417.) It may be that the sales prices were not as high as Mr. Heiner and Utah Fuel would have liked them to be, but the evidence indicates that

the prices were necessarily adopted to meet open and free competition in the market. And precisely for that reason, Utah Fuel's prices reflected the typical or representative market prices. In the language of *Alabama By-Products Corp. v. Patterson*, 258 F. 2d 892, 899-900 (C.A. 5th):

Although the sales made by the taxpayer were in the nature of "forced" sales owing to peculiar economic conditions, the sales of coking coal by the other companies were the natural result of competitive bargaining, and principles of supply and demand. This is enough to create a true market in commerce. *Helvering v. Walbridge*, 2 Cir., 1934, 70 F. 2d 683; *Heinver v. Crosby*, 3 Cir., 1928, 24 F. 2d 191.

Next, taxpayer contends that Utah Fuel's sales prices for its Sunnyside coal were irrelevant because they were sold for uses other than making coke, which is the use taxpayer's coal was sold for. But the courts have not attached importance to a distinction based upon the actual use of minerals by purchaser; whether one mineral is of "like kind and grade" with another depends upon its characteristics and potential use. As the Fifth Circuit said in *United States v. Henderson Clay Products*, *supra*, p. 11, "minerals are of like kind and grade if they are substantially equivalent by commercial standards. * * * the question is not whether the products were actually used for the same commercial purpose but rather whether they *could* have been so used." Thus in *United States Pipe & Foundry Co. v. Patterson*, *supra*, the District Court relied on sales of coking coal for non

coking uses to arrive at a representative market price for the taxpayer's coking coal, as did the District Court in *Alabama By-Products Corp. v. Patterson*, 151 F. Supp. 641. In affirming the latter decision the Fifth Circuit said in part (258 F. 2d 898-899):

The District Court concluded that all bituminous coals in the Alabama fields are of like grade if commercially suitable for use in the manufacture of coke generally, regardless of the taxpayer's particular needs. To go further and classify coking coals according to their myriad of actual uses would lead to an unworkable system of grading coal, since the requirements of coke users vary so greatly. There would never be in the case of coking coal, a "mineral product of like kind and grade"; we would have a phrase without meaning.

In essence, taxpayer argues that it is entitled to additional depletion because its coal has more value when it is sold for coking coal than it has when it is sold for commercial purposes, in competition with ordinary coal. Aside from the fact that depletion is not computed on value, taxpayer's argument is unsound on several counts. First, if taxpayer's coal could in fact command a higher price when sold for coking purposes, it would have been sold as such and not at lower prices for commercial purposes. But both taxpayer and Utah Fuel sold Sunnyside coking coal for commercial purposes. (I-R. 42, 44.) Second, the evidence offered at trial in fact linked the purchase of Sunnyside coal for coking purposes to the price

which the seller received for its coal sold for *commercial* purposes.⁹

Suppose Utah Fuel and taxpayer decided to charge a premium price for Sunnyside coal because of its coking qualities; a potential buyer could easily turn to other sources of supply. For example, the St. Louis, Rocky Mountain & Pacific Company was selling its Raton-Mesa coal on the open market (II-R. 218-219) and there were several companies in the Trinidad, Colorado area (Deft. Ex. H) as well as in the Durango, Colorado (II-R. 310) and the Socorro, New Mexico area (II-R. 230) which were selling coking coal. With these alternative sources, a potential buyer would hardly be likely to pay a premium price for Sunnyside coal. There were simply too many miners of coking coal willing to sell and to sell at competitive commercial prices.

In the instant case the District Court found (I-R. 44) that the Sunnyside coal mined by Utah Fuel and taxpayer, respectively, had identical characteristics and were in fact interchanged in usage, and hence were coals "of like kind and grade". These producers sold their coal on the open market, in the same

⁹ In paragraph 9 of the lease between taxpayer and Utah Fuel covering taxpayer's lease of Sunnyside Mine # 2 (Pltf. Ex. 32), taxpayer was given the right for one year to purchase Sunnyside Mine # 1 coal at the commercial prices which Utah Fuel then received. And, in the contract dated January 29, 1948, between Utah Fuel and Kaiser-Frazer (Pltf. Ex. 20, par. VII), where a price of \$4.50 per ton for Sunnyside coal was arrived at by negotiation (II-R. 339), Kaiser-Frazer was given the right to purchase Sunnyside coal at any more favorable price which Utah Fuel granted to any of its commercial customers.

area, for similar prices, and the District Court was clearly justified in taking Utah Fuel's prices into account in determining the representative market price for taxpayer's coal.

2. Taxpayer's sales of Sunnyside coal

During the fiscal years in suit, taxpayer sold the following net tonnages of its Sunnyside coal on the open market (as the District Court found) at the indicated weighted average prices per net ton:

<u>Fiscal year</u>	<u>Net tons sold</u>	<u>Average price per ton</u>
1949	25,260	\$5.01
1950	28,340	4.89

Taxpayer contends in the first instance, that these sales were not indicative of a representative market price because they were "accommodation transfers". (Br. 50). It is true that the sales were so labeled in the testimony of Mr. Heers, taxpayer's Manager of Mines and Raw Materials; but there is no indication whatsoever in Mr. Heers' testimony (II-R. 94-101) that—apart from taxpayer's sales to Kaiser-Frazer Parts—taxpayer was ever willing to sell its Sunnyside coal, or ever did sell it, for less than the going market price.

In this connection, it may be noted that, during the four fiscal years following the years in suit, taxpayer continued to sell its Sunnyside coal at average prices per net ton (ranging from \$5.14 to \$4.83) which were very close to its average prices during the taxable years. And it sold very substantial tonnages at such

prices during fiscal 1951 and 1952—227,085 tons during fiscal 1951 and 311,208 tons during fiscal 1952. (Deft. Ex. II.) We submit that the history of taxpayer's market sales over the six fiscal years 1949-1954—given the relatively small fluctuation in its prices between \$5.14 and \$4.83 and the large ton-nages sold in at least two of those years—is incompatible, to say the least, with its assertion that it sold its coal during the years in suit at “accommodation” prices unrelated to the going market price.

Taxpayer itself originally regarded its sales prices during the taxable years as representative market prices; it used weighted average prices based on its own sales (excluding a sale at cost to Kaiser-Frazer Parts) in computing its depletion allowances. (I-R. 42-43.) Taxpayer's subsequent changes of position were unwarranted.¹⁰ There is no evidence whatever in the record that coking coal of the Sunnyside type was sold in the West during the taxable years at the prices which taxpayer now contends were representative. To the contrary, as appears below, all the evidence of contemporary sales of such coal confirms taxpayer's initial view (in which the Commissioner concurred) that its own prices were reasonably representative or typical of the going market price.

¹⁰ The record indicates that taxpayer has relied on a variety of formulas and sales data at different times during this proceeding, including Connellsville, Pennsylvania, coke prices (Deft. Ex. U), an “imputed” coal price derived from certain undisclosed formulas (II-R. 427-485), Raton-Mesa coal prices with “recognized adjustments” (Br. 51-58), and a weighted average of low-volatile Arkansas-Oklahoma blending coal (Br. 58-62).

3. *Sales of Raton-Mesa coal from the Koehler mine*

High-volatile coking coal is defined as coking coal containing less than 69 per cent fixed carbon and 31 to 42 per cent volatile matter. (I-R. 46.) During the taxable years the St. Louis, Rocky Mountain & Pacific Company of Raton, New Mexico (hereinafter "Raton") sold on the open market very substantial tonnages of high-volatile coking coal from its Koehler mine, which was located in the Raton-Mesa area of New Mexico and Colorado. Raton supplied from its Koehler mine nearly all of the 1,597,374 net tons of Raton-Mesa high-volatile coking coal purchased in the open market by the Colorado Fuel and Iron Company of Pueblo, Colorado, during the three calendar years (1948-1950) which overlapped the fiscal years in suit. Colorado Fuel paid a weighted average price f.o.b. the mine of \$4.97 in 1948, \$5.24 in 1949, and \$5.43 in 1950. Additionally, during the calendar years 1947-1950, Raton sold varying tonnages of Koehler coal to many other purchasers—including the instant taxpayer. These sales (which were not on a long-term contract basis) reflect prices per ton ranging from a low of \$2.50 in each of the years (on sales to retail dealers) to a high in 1948, 1949, and 1950 of \$5.65 on sales to the New Mexico Penitentiary. Most of the sales were made at prices under \$5. (I-R. 47-48.)

The Koehler high-volatile coking coal differed somewhat from the Sunnyside high-volatile coking coal in composition and characteristics, with differing advantages and disadvantages. (I-R. 46, 49.) However, the District Court found that the advantages of

each coal over the other minimized the competitive economic differences between them; that both were suitable for production of coke when blended with low-volatile coal; and hence that they were minerals of like kind and grade. The court further found that Koehler coal and Sunnyside coal competed directly in the same market, where they were sold for production of coke and also "extensively sold" for non-coking purposes. (I-R. 50.)

Given these findings on market competition, together with the data as to sales prices of Koehler coal set forth in detail in earlier findings (I-R. 47-48), the District Court found as an ultimate fact (I-R. 50) that the Koehler prices confirmed the representative market prices of Sunnyside coal as reflected in Utah Fuel's prices for such coal. We submit that the record amply warrants the findings with respect to the Koehler coal and sales prices therefor.

Taxpayer concedes (Br. 53) the correctness of the District Court's findings that Raton-Mesa and Sunnyside coal competed directly in the same market, were both suitable for production of coke when blended with low-volatile coal and were similarly utilized. However, it contends (Br. 52-54) that only the sales of Raton-Mesa coal from the Koehler mine to Colorado Fuel, for coking purposes, were indicative of a representative market price for its Sunnyside coal. Taxpayer asserts (Br. 52) that these sales to Colorado Fuel were (apart from small sales to the same purchaser by other Raton-Mesa producers) "the only sales of high volatile coking coal in the West for coking purposes * * * and the only sales of coking coal

for any purpose which were made in the course of competitive transactions". It dismisses (Br. 53-54) the sales of Koehler coal for non-coking purposes as nonrepresentative, both by reason of end use and on the asserted ground that (apart from the sales to Sante Fe) "the sales were in small amounts and were entirely for steam or domestic purposes". These assertions are contrary to the record and the findings of the District Court and, in any case, do not support the dollar figure which taxpayer now contends was the representative market price.

First, the facts. Raton did indeed sell very substantial tonnages of Koehler coal to Colorado Fuel; they constituted nearly all of the 1,600,000 tons of Raton-Mesa coal purchased by Colorado Fuel over the three calendar years 1948-1950. (I-R. 47-48.) But Raton's sales of Koehler coal to other purchasers during the same years were also substantial, totaling in excess of 800,000 tons. Moreover, one of the largest purchasers in this group was the instant taxpayer, who purchased approximately 70,000 tons of Koehler coal during the two years 1949-1950. (I-R. 38.) In view of its own substantial purchases, taxpayer would appear to be inaccurate in its assertions that only the sales to Colorado Fuel were for coking purposes, and that sales of Koehler coal to other purchasers were entirely for heating or making steam.¹¹

¹¹ Taxpayer asserted on brief in the District Court that it purchased the Koehler coal to test its quality. Presumably, taxpayer tested the 70,000 tons by using it to produce coke which, in turn, was used in taxpayer's blast furnace operations. The record also shows that Koehler coal was sold for test coking

Taxpayer is similarly inaccurate in asserting that the sales of Koehler coal to Colorado Fuel were the only sales in the West of coking coal, for whatever purpose, which were made in competitive transactions. The District Court found that both taxpayer and Utah Fuel sold their Sunnyside coal at arm's-length on the open market. (I-R. 42-44.) It also found that the Raton-Mesa coal and the Sunnyside coal competed directly in the same market, and were sold extensively in that market for non-coking uses as well as production of coke. (I-R. 50.) Additionally, the court noted that sales of Koehler coal to purchasers other than Colorado Fuel were not sold on a long-term contract basis. (I-R. 49.) These findings, in relation to Koehler coal, are underscored by the testimony of Mr. Kastler, who was Raton's vice-president during the taxable years. (II-R. 179.) Mr. Kastler testified with respect to the Koehler coal (II-R. 184):

Well, we were selling some to the Santa Fe Railroad, some to government installations such as government hospitals, and to some retail dealers, some power plants, C. F. & I. (Colorado Fuel). In fact, I think we tried to sell to whoever would want to buy at that time.

With regard to how the prices were fixed on the sales to Kaiser, Mr. Kastler testified (II-R. 201): "By negotiation, I would say. We would try to figure out about what price they might be paying their other source of supply".

purposes to the Lone Star Steel Corporation, the Sheffield Steel Corporation and U.S. Steel, Columbia-Geneva. (II-R. 197-199.)

In sum, it is clear that Raton's sales of Koehler coal to purchasers other than Colorado Fuel were substantial by any standard and were competitively negotiated in the open market—a market in which Koehler coal was in direct competition with Sunnyside coal as a mineral of “like kind and grade”. Accordingly, these sales of Koehler coal, as well as the sales to Colorado Fuel were properly taken into account by the District Court in reaching its ultimate finding that Koehler prices confirmed the representative character of Utah Fuel prices.

As for the taxpayer's contention that sales of Koehler coal for non-coking uses are irrelevant, we have already dealt with that “end use” argument as raised by taxpayer with respect to Utah Fuel's sales of Sunnyside coal. If one mineral has the same potential uses as another, it is a mineral of “like kind and grade”, and its sales are probative of a representative market price. *United States v. Henderson Clay Products, supra*; *Alabama By-Products Corp. v. Patterson, supra*; *United States Pipe & Foundry Co. v. Patterson, supra*. As the Fifth Circuit said in *Alabama By-Products Corp.*, 258 F. 2d at pp. 898-899: “To * * * classify coking coals according to their myriad of actual uses would lead to an unworkable system of grading coal * * *. There would never be in the case of coking coal, a ‘mineral product of like kind and grade’; we would have a phrase without a meaning”.

Finally, taxpayer would not be entitled to the relief sought in this litigation even if, as it contends (Br. 54), the sales to Colorado Fuel alone were the “sig-

nificant sales * * * which establish a representative market price". In its complaint, as in its claims for refund, taxpayer claimed depletion allowances for its fiscal years 1949 and 1950 based on representative market prices of \$9.90 and \$8.85 per ton, respectively. (I-R. 41-42.) On appeal, taxpayer has scaled these figures down to \$6.585 and \$6.933. (Br. 57-58.) But the average prices at which Koehler coal was sold to Colorado Fuel during the calendar years 1948 through 1950 were \$4.97, \$5.24 and \$5.43, respectively (I-R. 47)—or an average for 1948-1949 of \$5.105 and for 1949-1950 of \$5.335. The figures claimed by taxpayer are nearly 30 per cent higher than the latter averages. And this is without taking into account the sales of Koehler coal for coking purposes to purchasers other than Colorado Fuel—including the sale of 70,000 tons to taxpayer itself, competitively negotiated, according to Mr. Kastler of Raton (II-R. 184) and averaging only \$4.60 for 1949 and \$5-\$5.25 for 1950 (I-R. 49).

By contrast, the representative market prices for the years in suit as found by the District Court (\$4.75 and \$4.87 (I-R. 45)) are only 7 per cent and 8 per cent less, respectively, than the average prices paid by Colorado Fuel for 1948-1949 and 1949-1950.

Taxpayer seeks to bridge the substantial gap between the prices paid by Colorado Fuel and its claimed representative prices by "adjustments" which it asserts (Br. 55-58) must be made to account for the "undesirable" ash content in Koehler coal and the fact that such coal was sold in an unwashed condition. Taxpayer cites only *United States v. Henderson Clay*

Products, supra, as authority for such "adjustments" in determining a representative market price by reference to sales of minerals of "like kind and grade", and—as is evident from the very language quoted from that decision by taxpayer (Br. 57)—*Henderson Clay Products* is wide of the mark. That case states that (324 F. 2d at p. 11): "Physical, chemical and geological differences have importance only if they give rise to differences in commercial competition". In the instant case the District Court, after discussing ash content, washing and plasticity, found that (I-R. 50):

Comparison of the coal mined by Raton from the Koehler mine with the Sunnyside coal shipped by plaintiff shows that the Sunnyside coal contains more fixed carbon (premium) and more sulphur (penalty) than the Raton coal. On the other hand, the Raton coal has more ash (penalty) while having more plasticity (premium) than the Sunnyside coal. The advantages of each coal over the other minimize the competitive economic differences between them.

Taxpayer acknowledges (Br. 58), in effect, that a sulphur content of over 1 per cent "becomes troublesome in the blast furnace process". The "troublesome" consequence, brittle steel which fractures easily, may only be offset by expensive processes. (II-R. 968-970.) Taxpayer's Sunnyside coal contained 1.29 per cent of sulphur in 1949 and 1.12 per cent in 1950, whereas Raton coal contained only .78 per cent and .75 per cent, respectively, in those years. (I-R. 46-49.) Taxpayer errs in arguing that the record

discloses no basis for regarding sulphur content as a detriment reflected in pricing. Taxpayer's own Manager of Mines and Raw Materials testified (II-R. 92) that, for each one-tenth of one percent of sulphur content, there is a value difference of from 5 to 10 cents per ton and that such adjustments were made in purchasing and selling coal. Thus, in the coke contract between Utah Fuel and American Smelting & Refining, provision was made for a penalty of excessive sulphur. (Deft. Ex. EE, par. V.)

Taxpayer is similarly in error in its assertion (Br. 58) that differences in plasticity are immaterial. The District Court found that (I-R. 49): "Plasticity gives the coke physical strength so that it does not pulverize or break down in the blast furnace", and "the stronger the coke * * * the more desirable the coal for coking purposes". The court further found that (I-R. 49) the results of all three tests of plasticity showed that "the Raton coal has greater plasticity than plaintiff's Sunnyside coal and would, consequently, tend to form a stronger coke", and that this was "confirmed by the evidence of tests of coke strength conducted by plaintiff. (Ex. PP.)" In unrebutted testimony, Dr. Johnson, a consulting geologist, stated (II-R. 1001) that the greater plasticity and lower sulphur content of the Raton coal resulted in a "standoff" between that coal and Sunnyside coal. As noted, the District Court so found.

In short, even on taxpayer's own theory—that the representative market prices are the prices paid by Colorado Fuel with "adjustments" for differences between Koehler and Sunnyside coal—the dollar figures

claimed by taxpayer are unsupported. The differences between the two coals for coking purposes offset each other in a "standoff" in the open market in which they competed directly with each other. Thus taxpayer is left with a differential of 30 per cent between the prices paid by Colorado Fuel and its claimed dollar figures, whereas there is only a minimal difference of 7 to 8 per cent between the Colorado Fuel prices and the representative market prices derived by the District Court from the sales of Sunnyside coal by Utah Fuel and taxpayer. Moreover, when sales of Koehler coal for non-coking as well as coking purposes are taken into account—as the District Court properly found they should be—the average market price of Koehler coal is even lower and, as the District Court further found, confirms the representative nature of the prices obtained by Utah Fuel and taxpayer.

It would be inappropriate to extend this brief with a detailed discussion of taxpayer's alternative contention (Br. 58-60) that its representative market prices are the prices paid for low-volatile Arkansas-Oklahoma blending coal—again with "adjustments". This coal is simply an additive in the coke-making process, a small portion being blended with a large quantity of high-volatile coking coal (such as the Koehler and Sunnyside coal) to arrive at a coke with optimum strength at most economical cost. It is high-volatile coking coal and its representative market prices which are at issue, and there is considerable sales data in the findings and the record with respect to such coal. It would obviously be inappropriate, in any event, to construct a hypothetical representative

market price for high-volatile coking coal from prices paid for the low-volatile additive which, as the District Court found (I-R. 47) is not a mineral product of "like kind and grade".

For all of the foregoing reasons, we submit that the District Court was amply warranted by the record in deriving the representative market price for Sunnyside coal from the sales of such coal on the open market by Utah Fuel and taxpayer, and in finding that competitive sales in the same market of Koehler coal confirmed the representative nature of Sunnyside prices.

D. The record amply warrants the District Court's finding that the sales prices obtained by Utah Construction and Mining Company for its iron ore established the representative market prices for taxpayer's iron ore

1. *Sales by Utah Construction and Mining Company*

In manufacturing its iron and steel products, taxpayer used iron ore which it mined from its Vulcan Mine and Eagle Mountain Mine, both in California, together with iron ore purchased from other miners. (I-R. 33-34.) Utah Construction and Mining Company (hereinafter Utah Construction) was an independent company mining and selling iron ore from its mine at Iron Springs, Utah. From 1946 to 1954, Utah Construction sold substantial tonnages of iron ore to taxpayer. The ore thus purchased constituted over 20 per cent of the iron ore consumed by taxpayer during the years in suit. Utah Construction also sold large tonnages of its ore to many other customers, including cement companies. (I-R. 35-37.)

The District Court found (I-R. 39-40) that Utah Construction's iron ore, whether used in a blast furnace, an open-hearth furnace, or in the manufacture of cement, was a mineral product of "like kind and grade" to the ore mined by taxpayer. The court further found (I-R. 40-41) that Utah Construction's sales during the years in suit to its various customers, including taxpayer, "were arm's-length transactions in which ore moved in commerce in an area which included [taxpayer's] mines and therefore established a representative market price for iron ore mined and shipped" by the taxpayer from its California mines.

Taxpayer paid Utah Construction an average price per net ton f.o.b. Iron Springs of \$1.869 during its fiscal year ended June 30, 1949, and \$1.901 during its fiscal year ended June 30, 1950. The weighted average f.o.b. mine prices paid by all Utah Construction's customers, including taxpayer, during its fiscal years ended October 31, 1948, 1949 and 1950, were \$2.04, \$2.39 and \$1.88, respectively. (I-R. 36-37.) The District Court found (I-R. 41) that the representative market prices for taxpayer's iron ore during the taxable years were \$2.29 and \$2.03 per net ton, respectively. Taxpayer claims substantially higher dollar figures as the representative market prices of its iron ore. (I-R. 34-35.) In attempting to support these figures on appeal, taxpayer asserts that Utah Construction's prices were not representative market prices and invokes other sales data, discussed below.

Before discussing taxpayer's arguments as to Utah Construction's prices, it should be recalled that the governing regulation speaks only of a "representative

mist, appearing as taxpayer's own witness, testified (II-R. 639-640) that a market existed for Utah Construction's ore. This perhaps is supererogatory; the existence of the market is attested by the very substantial tonnages sold by taxpayer to a variety of customers.

As for the substantial sales for export to Japan, these sales did not reflect a "temporary business opportunity," but rather was a significant and continuing segment in the western iron ore market both during the years in issue and thereafter. After the Japanese iron ore market reopened in 1948 with the sales by Utah Construction, iron ore was exported from the United States to Japan in every year from 1948 through 1953 save for 1950¹² with Utah Construction alone selling for export 48,000 tons in its fiscal year 1948, 309,000 tons in its fiscal year 1949 and 717,000 tons in its fiscal year 1951. (Exs. A, U.) And, the continuing and expanding character of the Japanese export market was later corroborated by taxpayer's own sales of substantial quantities of Eagle Mountain iron ore to the Japanese commencing in 1956. (Ex. 22, II-R. 756-757.) Moreover, whatever limitations taxpayer claims were put on the price that Utah Construction could charge for the iron ore which was to be exported are of no import for Utah Construction was not forced to make any of these sales if it felt it was receiving an inadequate price therefore.

¹² United States Department of the Interior—*Materials Survey, Iron Ore*, May, 1956.

Taxpayer summarily dismisses sales of iron ore by Utah Construction to cement companies for use in making cement and to foundries for use in open-hearth furnaces as being sales "of a different commodity or for a special purpose." (Br. 31.) As noted above, iron ore sold by Utah Construction, whether for use in a blast furnace, an open-hearth furnace or by a cement company, had the same physical and chemical characteristics, varying only in the size of the lumps. It is therefore not a different commodity. Nor, as was fully discussed in that section of this brief devoted to coal, does a sale for a different end use exclude such sale from being used to determine a representative market price for the same mineral.

Finally, taxpayer urges that the District Court erred in using Utah Construction's mine price because (Br. 41) "the 'mine' price which is to be used for the purpose of depletion can only be derived at by deducting from the representative market price paid by the buyer the segment of that price which consists of the cost of delivering that ore from the mine to the buyer." That is, taxpayer urges that a representative market price be found and that a "mine" price be derived therefrom. (See Br. 42-44.) In addition, taxpayer urges that the District Court erred even in selecting the mine price to be used. The use by the District Court of the Utah Construction mine price is supported by Treasury Regulations 111, Sec. 29.23 (m)-1 which states:

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the *representative market or field price* (as of the date of sale) of a *mineral product of like kind and grade* as benefited by the ordinary treatment processes actually applied, *before transportation* of such product.

Thus, the applicable Regulations make no distinction between representative market or field price and mine price, but rather equates the two since the representative market or field price is to be determined *before* the mineral is transported away from the mine, i.e., is to be determined by the price paid for the mineral of like kind and grade where mined.

2. *Lower Lake port prices for Mesabi Range iron ore cannot be used to establish a representative market price for taxpayer's iron ore*

Taxpayer urges that lower Great Lakes port prices be used as the measure for its own iron ore. A recent decision is pertinent here.

In *Ames v. United States*, decided November 13, 1962 (10 A.F.T.R. 2d 5963) (Ariz.), affirmed, 330 F. 2d 770 (C.A. 9th), the taxpayer produced crushed limestone from its quarry in Arizona. It did not sell this limestone but used it in its adjacent plant to make calcined lime which it then sold. The sole issue in the case involved the determination of the rep-

representative market price for the taxpayer's limestone. At the trial, evidence was received showing sales of limestone in Arizona, in the Sacramento-Placerville area of California, and in Michigan. The District Court found a representative market price for the taxpayer's limestone on the basis of the Arizona sales. It also held that the California and Michigan sales were of no weight because of the remoteness of the sites of such sales from the area of the taxpayer's operations, and the differences as to size and quality of the materials involved and the absence of evidence regarding comparative shipping costs.

The court in *Ames* thus recognized the obvious fact that in order for sales to have significance they must bear some relation to the circumstances of the particular taxpayer involved. Thus, the California and Michigan sales were found to have no bearing on the search for a representative market or field price for limestone mined by the taxpayer in Arizona in the absence of evidence relating these sales to the taxpayer's mineral.

Similarly, in the instant case, the record evidence shows and the District Court found (I-R. 40) that taxpayer had neither bought nor sold iron ore in the Lower Lake port market or at Lower Lake port prices and that no iron ore extracted in the Great Lakes region of the United States was sold or shipped to the Western United States from the Lower Lake ports. And, taxpayer's own witness, Mr. Pardee, admitted (II-R. 612) and the District Court found (I-R. 40) that the Lower Lake port pricing structure for iron

ore did not constitute a "national representative market" for iron ore.¹³

Whatever else may then be said about Lower Lake port prices, it is evident that they have no relationship to taxpayer's iron ore and are simply not in any way representative of a market price for taxpayer's ore. From the record evidence, the only iron ore prices that do bear significant relationship to taxpayer's ore are the Utah iron ore prices which include sales of such ore to taxpayer. The extent of taxpayer's own purchases of this Utah ore indicates that it was satisfactory for use in taxpayer's blast furnace along with its own iron ore and that it was economically feasible to ship the ore from Utah to California. To disregard the Utah ore prices and to turn to Lower Lake port prices for Mesabi Range ore as being representative of taxpayer's iron ore makes no sense and would involve construing the phrase "representative market or field" in a manner so broad as to render the term meaningless.

In order for market prices to be representative of the taxpayer's mineral, they must be typical of the price which taxpayer's mineral would command if it

¹³ That the Lower Lake port pricing structure does not establish a national pricing system for iron is not surprising because approximately 75 to 80 percent of the iron ore shipped to the Lower Lake ports is captive ore (the same as the ore mined by taxpayer for its own use) and the actual prices at which iron ore is sold at the Lower Lake ports are generally lower than the published prices owing to discounts from the base prices contained in many of the sales contracts. (II-R. 606-607.)

were offered for sale. Prices, on the other hand, cannot be representative if they are established in a totally unrelated market in which the taxpayer did not and could not participate even if it desired to do so. But, that is precisely the situation with respect to taxpayer's ore and the proposed use of Lower Lake port prices to establish a representative market price therefore. They are simply unrelated. By way of contrast, the Utah iron ore prices bear an actual proven relationship to taxpayer's iron ore which taxpayer cannot explain away and which relationship is absent in the case of the Lower Lake port prices. As found by the District Court (I-R. 40) :

The sales of iron ore in the Great Lakes region, either at the mine or at the lower Great Lakes ports, are of no weight in this case because of the remoteness of the sites of such sales from the area of plaintiff's operations and the absence of any sales or shipments of such ore to the area of plaintiff's operations. The Great Lakes area was an independent market insofar as the plaintiff is concerned and sales within that independent market area had no economic effect upon plaintiff's market area and did not establish or effect the representative market area and did not establish or effect the representative market price for either Eagle Mountain or Vulcan iron ore.

Continuing, the court stated with regard to the sales of Utah iron ore, that (I-R. 40-41) :

The sales of iron ore by Utah Construction and Mining Company during the years in suit to its various customers, including plaintiff, were

arm's-length transactions in which ore moved in commerce in an area which included plaintiff's mines and therefore established a representative market price for iron ore mined and shipped by plaintiff from its Vulcan and Eagle Mountain Mines during the years in suit.

We submit therefore that the Utah iron ore prices are relevant, that they are representative and that they, not Lower Lake prices, should be used in determining taxpayer's gross income from mining its ore.

In addition to our basic disagreement with the use of Lower Lake port prices to establish a representative market price for taxpayer's iron ore, issue must also be taken with the manner in which taxpayer attempts to construct such price. The fallacy in taxpayer's use of Lower Lake port prices lies in the fact that such prices include assorted charges such as rail freight from the mine to Upper Lake ports, lake freight to Lower Lake ports, dock unloading charges, federal transportation taxes, interest, insurance, and other incidental charges. (Ex. SS, p. 240.) Depletion, however, is an allowance for the exhaustion of a capital asset (*United States v. Cannelton Sewer Pipe Co.*, *supra*) and under the Code, the measure of this capital asset is "gross income from mining". Therefore, only those costs which are incurred in connection with the taxpayer's mining operation are properly includible in any determination of income from mining. As the Lower Lake port prices include the charges enumerated above—all of which are incurred after the mining operation is completed—use of Lower Lake port prices in connection with computing gross

income from mining under any method is manifestly improper and contrary to the applicable depletion statute and Regulations. Taxpayer apparently recognizes the difficulty in its failure to use mine price for it states (Br. 36) that "since we are concerned with a mine price, for it is also necessary to reduce this adjusted price by the freight from the Eagle Mountain and Vulcan mines to Fontana." Although the deduction of that freight charge reduces the price used, it nevertheless fails to remedy the basic error in the use of the Lower Lake port prices due to the inclusion in that price of charges incurred subsequent to the mining operation.

Nor does taxpayer's effort to derive a price for its iron ore based on an assumed relationship between the price of iron ore and the finished steel prices of the Eastern producers support the use of Lower Lake port prices. For our purposes, however, the testimony on this point by taxpayer's witness, Mr. Carrier, is interesting for several reasons. Mr. Carrier stated that, as an initial step, careful attention was given to the actual sales of iron ore in the West in the years 1949 and 1950 because sales prices in a free and competitive market in the general area in which the captive ore was located would tend to be the best evidence available of a representative market price. (II-R. 633.) He discarded the actual sales of Utah iron ore, however, because in his view, the market for Western iron ore was "very thin". (II-R. 639-640.) Thus, at the outset, the market for Western iron ore,

though conceded to have existed during the years in issue, was discarded in favor of some other market.¹⁴ Implicit in this action was an assumption that "representative market or field price" within the meaning of the Treasury Regulations, required some particular or pre-conceived type of market.¹⁵ As was discussed earlier in this brief, the assumption is erroneous. Under the applicable Regulations, in order for the comparative market method to be applicable, the requirement is that there be a market¹⁶—not a "fat" one or a "thin" one, but simply a market. In Mr. Carrier's view, there was a market for Western iron ore during the years in issue, albeit a "thin" one, and that market included the sales of iron ore by Utah Construction to taxpayer and several other purchasers. Without anything more, we submit that on

¹⁴ The method he eventually used in calculating an "imputed" price for taxpayer's ore involved the development of a mathematical formula and working back from statistics on pig iron prices to his hypothetical iron ore price.

¹⁵ Thus, Mr. Carrier stated that a representative market price had to stem from a free and competitive market but that "outside of the world of abstract economics and textbooks there is no such thing as a perfectly free and competitive market". (II-R. 641.) Apparently in Mr. Carrier's view it would only be the extremely rare and unusual market that would produce representative market prices for purposes of computing income from mining for depletion purposes under the applicable Treasury Regulations. As noted earlier, there is no basis under the Regulations or in the decided cases for such a restricted interpretation.

¹⁶ Given such a market, prices established therein, in Mr. Carrier's words, "would tend to be the best evidence available of a representative market price". (II-R 633.)

Mr. Carrier's testimony alone, we have the market which reflects the representative market or field price for taxpayer's ore and which resolves this issue.

Finally, it must be noted that taxpayer in its attempt to support its claim for a higher depletion allowance was not satisfied to use Lower Lake prices by themselves but insisted upon making upward adjustments to the port price to compensate for the greater iron content of its ore over that of the Mesabi non-Bessemer ore. As was discussed earlier in great detail, such adjustments do not result in a representative market price being reached, but rather are concerned only with the relative values of minerals—a determination which is not here in issue. Moreover, taxpayer in making adjustments to a base price again, as it did with regard to the adjustments made on the coal prices, he failed to make downward adjustments for an adverse quality of its mineral. In the case of iron ore, taxpayer has failed to adjust downward its derived value for the greater sulphur content (a deleterious element) of its iron ore over that contained in the Mesabi non-Bessemer ore.

In summary, the record evidence establishes the existence of a continuing market with respect to Utah iron ore in which taxpayer was an active participant. Moreover, taxpayer itself recognized the existence of this market when it originally prepared its tax returns for the years in issue. The Utah iron ore prices are now unsatisfactory to taxpayer because they are not high enough to support its claim for greater depletion allowance. But, its claim that these sales can be "explained away" simply does not stand up under

the heavy weight of the evidence to the contrary. Accordingly, taxpayer's depletion allowance for its iron ore was properly determined by the District Court on the basis of the Utah iron ore prices.

CONCLUSION

For the reasons stated above, the decision of the District Court should be affirmed.

Respectfully submitted,

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APRIL, 1968.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: day of, 1968.

Attorney

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(m) *Depletion*.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

For percentage depletion allowable under this subsection, see section 114(b), (3) and (4).

(n) *Basis for Depreciation and Depletion.*—

The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114 [as amended by Sec. 145(a), Revenue Act of 1942, c. 619, 56 Stat. 798; Sec. 124(a) and (c), Revenue Act of 1943, c. 63, 58 Stat. 21; and Sec. 15(b), Act of August 8, 1947, c. 515, 61 Stat. 917]. BASIS FOR DEPRECIATION AND DEPLETION.

* * * *

(b) *Basis for Depletion.*—

* * * *

(4) *Percentage depletion for coal, bauxite, fluor spar, flake graphite, vermiculite, beryl, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball sagger, and china clay, rock asphalt, phosphate rock, trona, bentonite, gilsonite, thenardite, and metal mines, potash, and sulfur.*—

(A) *In General.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, bauxite, fluor spar, flake graphite, vermiculite, beryl, feldspar, mica, talc (including

pyrophyllite), lepidolite, spodumene, barite, ball, sagger, and china clay, phosphate rock, rock asphalt mines, trona, bentonite, gilsonite, thenardite (from brines or mixtures of brine), and potash mines or deposits, 15 per centum, and in the case of sulfur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) *Definition of Gross Income From Property.*—As usual in this paragraph the term “gross income from the property” means the gross income from mining. The term “mining”, as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term “ordinary treatment processes”, as used herein, shall include the following: (i) In the case of coal—

cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluor-spar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purpose of sections 731 and 735.

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111:

Sec. 29.23(m)-1 [as amended by T.D. 5413, 1944 Cum. Bull. 124; T.D. 5458, 1945 Cum.

Bull. 45; and T.D. 5461, 1945 Cum. Bull. 284]. *Depletion of mines, oil and gas wells, other natural deposits, and timbers; depreciation of improvements.*—

* * * *

(f) The term “gross income from the property”, as used in sections 114(b)(3) and 114(b)(4)(A) and sections 29.23(m)-1 to 29.23(m)-19, inclusive, means the following:

* * * *

In the case of a crude mineral product other than oil and gas, “gross income from the property”, as used in section 114(b)(4)(A) means the gross income from mining. The term “mining” as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products.

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, “gross income from the property” means the amount for which such product was sold, but if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, “gross income from the property” means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as benefited by the ordinary treatment processes actually applied, before transportation of such product. If there is no such representative market or field price (as of the date of sale), then there shall be

used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

The term "ordinary treatment processes", as used herein, shall include the following:

(1) in the case of coal—cleaning, breaking, sizing and loading for shipment;

* * * *

(3) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment.

* * * *

